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**FEDERAL HOUSING FINANCE AGENCY**

**12 CFR Part 1231**

**RIN 2590-AA08**

**Golden Parachute and Indemnification Payments**

**AGENCY:** Federal Housing Finance Agency.

**ACTION:** Proposed rule; request for comments.

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**SUMMARY:** The Federal Housing Finance Agency (FHFA) is re-proposing the Golden Parachute and Indemnification Payments proposed rule that was published in the Federal Register on June 29, 2009 (the Proposal). Specifically, FHFA is addressing content set forth in the Proposal, both in the Supplementary Information and the regulatory text, which relates to prohibited and permissible golden parachute payments to entity-affiliated parties in connection with the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Banks, and the Office of Finance of the Federal Home Loan Bank System. This proposed rule (the “Re-proposal”) solicits comments on the appropriate treatment of golden parachute arrangements entered into before the effective date of the rule. Additionally, this Re-proposal responds to public comments received by FHFA on the golden parachute provisions, and provides clarification regarding coverage of retirement plans, which were the subject of significant concern expressed in the comments.

**DATES:** Written comments on this proposed rule must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN FEDERAL REGISTER]. For additional information, see **SUPPLEMENTARY INFORMATION**.

**ADDRESSES:** You may submit your comments on this proposed rule, identified by regulatory information number “RIN 2590-AA08,” by any one of the following methods:

- E-mail: Comments to Alfred M. Pollard, General Counsel, may be sent by e-mail at [RegComments@fhfa.gov](mailto:RegComments@fhfa.gov). Please include “RIN 2590-AA08” in the subject line of the message.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by e-mail to FHFA at [RegComments@fhfa.gov](mailto:RegComments@fhfa.gov) to ensure timely receipt by the agency. Please include “RIN 2590-AA08” in the subject line of the message.
- Hand Delivered/Courier: The hand delivery address is: Alfred M. Pollard, General Counsel; Attention: Comments/RIN 2590-AA08, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street, SW, Washington, DC 20024. The package should be logged at the Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service: The mailing address for comments is: Alfred M. Pollard, General Counsel; Attention: Comments/RIN 2590-AA08, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street, SW, Washington, DC 20024.

**FOR FURTHER INFORMATION CONTACT:** Alfred M. Pollard, General Counsel,

(202) 649-3050, Alfred.Pollard@fhfa.gov, or Lindsay Simmons, Assistant General Counsel, (202) 649-3066, Lindsay.Simmons@fhfa.gov (not toll-free numbers). The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877-8339.

## **SUPPLEMENTARY INFORMATION:**

### **I. Comments**

FHFA invites comments on all aspects of the Re-proposal and will take all comments into consideration before issuing the final regulation. Copies of all comments will be posted without change, including any personal information you provide, such as your name, address, email address, and telephone number, on the FHFA internet website at <http://www.fhfa.gov>. In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street, SW, Washington, DC 20024. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 649-3804.

### **II. Background**

Section 1114 of the Housing and Economic Recovery Act of 2008 (HERA) amended section 1318(e) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act) (12 U.S.C. 4518(e)) to provide explicit authorities to FHFA in addressing golden parachute payments and indemnification payments. FHFA published an interim final regulation on Golden Parachute and Indemnification Payments in the Federal Register on September 16, 2008 (73 FR 53356). Subsequently, it published corrections rescinding that portion of the

regulation that addressed indemnification payments on September 19, 2008 (73 FR 54309) and on September 23, 2008 (73 FR 54673). On November 14, 2008 (73 FR 67424), FHFA published in the Federal Register a proposed amendment to the interim final regulation that addressed indemnification payments. The public notice and comment period closed on December 29, 2008. On January 29, 2009 (74 FR 5101), FHFA published the final regulation on Golden Parachute Payments. On June 29, 2009 (74 FR 30975), FHFA published a proposed amendment to the final Golden Parachute Payments regulation that addressed in more detail, prohibited and permissible golden parachute payments. The proposed amendment noted that comments received in response to the November 14, 2008, publication addressing indemnification payments will be considered along with comments received in response to this amendment.

As noted in the Summary, this Re-proposal only addresses issues as well as comments received that relate to golden parachute payments. Comments received on indemnification payments will be addressed in the final rule on Golden Parachute and Indemnification Payments.

### **III. Golden Parachute Payments**

FHFA published a final regulation on Golden Parachute Payments in the Federal Register on January 29, 2009 (74 FR 5101). The final Golden Parachute Payments regulation addressed public comment on factors the Director would consider in acting on golden parachute payments. As stated in the Supplementary Information published with the final regulation, comments received that addressed other elements of a golden parachute regulation would be considered by FHFA in subsequent rulemaking for public comment. Specifically, in response to comments received, FHFA stated that it would

consider adding provisions similar to those of the Federal Deposit Insurance Corporation (FDIC) golden parachute regulation in the subsequent rulemaking. The FDIC regulation describes more specifically benefits included in or excluded from the term “golden parachute payment.” Thus, the provisions of the Proposal (published in the Federal Register on June 29, 2009) addressing golden parachute payments are substantially similar to the FDIC regulation that limits golden parachute payments by insured depository institutions to institution-affiliated parties.<sup>1</sup>

#### **IV. Comments Received on Golden Parachute Payments**

The Proposal (74 FR 30975 – 30981), which among other things, would have set forth the standards that the Director will take into consideration in determining whether to limit or prohibit golden parachute payments that its regulated entities and the Office of Finance (OF) may make to entity-affiliated parties.<sup>2</sup> The comment period on the Proposal closed on July 29, 2009.

FHFA received comments on the golden parachute provisions of the Proposal from the following: each of the 12 Federal Home Loan Banks (Banks); the Chairs of the 12 Banks; OF; and the Chair and Vice-Chair of the Bank of Boston.

##### A. General Comments

##### 1. Grandfathering and Coverage of Retirement Plans

In the Supplementary Information published with the Proposal, FHFA stated its intention to apply the golden parachute provisions to agreements entered into by a regulated entity or OF with an entity-affiliated party on or after the date the regulation

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<sup>1</sup> The FDIC regulation is found at 12 CFR part 359.

<sup>2</sup> To view the proposed rule, go to <http://www.fhfa.gov> or <http://www.regulations.gov>.

would be effective.<sup>3</sup> After considering further the types of golden parachute agreements that may currently be in place, FHFA is clarifying its stated intention. FHFA has determined to grandfather a defined subset of agreements as of the date the Re-proposal is published in the Federal Register, and that the rest will be subject to review by FHFA, as appropriate. Specifically, FHFA intends to grandfather all retirement plans and deferred compensation plans in place as of the Re-proposal's publication date. FHFA has reviewed all such current plans and has concluded that they are appropriately excepted from the scope of the golden parachute rule.

With respect to severance plans, FHFA intends to allow the entities three months from the effective date of the final rule within which they may submit for FHFA review severance plans that would be excepted under the terms of the regulation but for their having been adopted or modified at a time when the entity either was in, or was in contemplation of, a condition ("triggering event") specified in paragraph (1)(ii) of the definition of the term "golden parachute payment." After that three-month period, severance plans outside of the severance-plan exception to the term "golden parachute payment" must be reviewed by FHFA if the entity is subject to a triggering event.

FHFA notes that certain comments expressed concern that retirement plans could be affected by the regulation, contrary to the intent of the Proposal. In response to the uncertainty about the applicability of the Proposal's definition of "golden parachute payment," FHFA summarizes below the status of different arrangements.

- Qualified plans are excepted from the requirements of the regulation and, therefore, any changes to them do not require FHFA approval.
- Non-qualified retirement plans (either defined-contribution or defined-benefit

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<sup>3</sup> 74 FR at 30976 (June 29, 2009).

plans or deferred compensation plans) established for the benefit of executives whose participation in a regulated entity's qualified plans is curtailed by the Internal Revenue Service limits are "bona fide deferred compensation plans" if they meet the various requirements listed in the Proposal.<sup>4</sup> Such non-qualified plans meeting those requirements are therefore excepted from the Proposal's definition of "golden parachute payment."<sup>5</sup>

- All retirement plans established for the benefit of executives in place as of the Re-proposal's publication date are grandfathered. From the Re-proposal's publication date forward, any retirement plans that are not qualified, and that are not bona fide deferred compensation plans, and payouts on such plans, will qualify as golden parachute payments and will require FHFA review and approval, if the regulated entity is subject to a triggering event.
- Severance plans are excepted if they meet the various terms of the regulation (such as those that authorize payment, for executives whose salary is less than \$300,000, of no more than 12 months compensation, as discussed further below). As stated above, FHFA intends to allow the entities three months from the effective date of the final rule within which they may submit for FHFA review and approval existing severance plans that would be excepted but for their having been adopted or modified at a time when the entity was subject to a "triggering event" specified in paragraph (1)(ii) of the definition

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<sup>4</sup> Those requirements are the requirements enumerated in paragraphs (3)(i) through (3)(vii) of the definition of "bona fide deferred compensation plan or arrangement" in § 1231.2 of the Proposal, and in addition, with respect to plans under which an entity-affiliated party voluntarily defers a portion of his or her compensation that would otherwise be currently paid for services rendered, the requirements of paragraphs (1)(i) and (1)(ii) of that definition.

of the term “golden parachute payment.”

- Severance plans outside of the exception to the term “golden parachute payment” (such as nondiscriminatory severance plans for an executive whose salary exceeds \$300,000) are subject to FHFA review and approval if the entity is subject to a triggering event.
- Change-of-control agreements and ad hoc payments are not grandfathered or excepted and, therefore, require FHFA review and approval if the regulated entity is subject to a triggering event.

The Proposal’s definition of “golden parachute payment,” including the definition of “bona fide deferred compensation plan or arrangement” and other exceptions, substantially adopts that of the FDIC’s regulation on this subject, which was developed after careful review of industry practice with respect to retirement plans.<sup>6</sup> Banks and thrifts have been able to operate under that regulation for the past 15 years.

FHFA notes that, while the statute permits FHFA to prohibit or limit golden parachute agreements when a regulated entity is subject to a triggering event, the statute does not require FHFA to do so. It is FHFA’s intention to consider all facts and circumstances in exercising this discretionary authority, including the degree to which a proposed golden parachute payment represents a reasonable payment for services rendered over the period of employment.

The reconsideration of the treatment to be afforded golden parachute arrangements does not affect indemnification arrangements. As to those arrangements,

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<sup>5</sup> While the entities are not required to submit excepted plans for approval for purposes of the Golden Parachute and Indemnification Payments regulation, they are required to submit such plans for review for purposes of the proposed Executive Compensation regulation (74 FR 26989 (June 5, 2009)).

<sup>6</sup> See 56 FR 50529 (Oct. 7, 1991), 60 FR 16069 (March 29, 1995), 61 FR 5926 (Feb. 15, 1996).



FHFA reaffirms its intent<sup>7</sup> that the regulation apply to agreements entered into by a regulated entity or OF with an entity-affiliated party on or after the date the regulation is effective. FHFA believes that reliance on indemnification arrangements and their significance as an element of continuing employment and service weigh in favor of grandfathering these arrangements when reviewed against the goals set forth in the statute. Indemnification arrangements are subject to a separate proposed rulemaking, which will be combined with this Re-proposal in the final rule.<sup>8</sup>

## 2. Application of the Golden Parachute Payments Prohibitions and FHFA's Approval

All of the commenters sought clarification as to when the golden parachute prohibitions apply and whether approval by the Director of FHFA (the "Director") would be required. Their concern related to the triggering events listed in the Proposal in paragraphs (1)(ii)(A) through (D) in the definition of the term "golden parachute payment" in proposed § 1231.2. Their inquiries related to the timing of a triggering event and its effect on the ability of a regulated entity or OF to enter into an agreement with or pay an entity-affiliated party. The inquiries focused on one of the triggering events: a determination by FHFA that the regulated entity is in a troubled condition (paragraph (1)(ii)(C) of the term "golden parachute payment" in proposed § 1231.2). The following responds to the specific inquiries:

i. A regulated entity or OF need not obtain the approval of the Director to enter into an agreement with or to pay an entity-affiliated party under the following circumstances:

- A regulated entity or OF is not subject to any of the triggering events listed in

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<sup>7</sup> 73 FR 67424, 67425 (Nov. 14, 2008).

<sup>8</sup> 73 FR 67424 (Nov. 14, 2008).

paragraphs (1)(ii)(A) through (D) of the term “golden parachute payment” in proposed § 1231.2;

- A regulated entity or OF is no longer subject to a triggering event (e.g., it has emerged from a troubled condition); or
- An entity-affiliated party begins to receive payments under an agreement prior to the occurrence of a triggering event that continue after the triggering event, if the entity-affiliated party’s employment was not terminated in contemplation of the triggering event.

ii. A regulated entity or OF, when subject to a triggering event, must obtain the permission of the Director in order to pay, or enter into an agreement to pay, an entity-affiliated party if it:

- Terminates an entity-affiliated party’s employment;
- Enters into an agreement with an entity-affiliated party providing a golden parachute payment;
- Amends an employment contract containing golden parachute provisions with an entity-affiliated party;
- Renews an employment agreement (including automatic renewal) with an entity-affiliated party that contains severance provisions; or
- Makes a payment related to a change in control (not resulting from conservatorship or receivership).

In any circumstance in which an agreement that provides for a golden parachute payment has been approved by the Director, an additional approval by the Director is required in order to make such a payment under the agreement if the entity is subject to a

triggering event. The FHFA regulation, similar to the statute it implements (HERA), limits a regulated entity that is subject to a triggering event from making golden parachute payments or entering into agreements to make golden parachute payments. As a consequence, FHFA may review a golden parachute payment at the time it is being made, notwithstanding a prior approval of the particular golden parachute agreement. This “double approval” process mirrors the practice of the FDIC for institutions subject to its golden parachute payments regulation.

The double approval process is supported by the following considerations. First, an agreement containing provisions that the regulator considers unreasonable for an entity subject to a triggering event should be disapproved without waiting for payments to be made under it, so that the regulated entity can develop an alternative acceptable arrangement and so that executives will not be relying on an agreement under which they will not, in the event, be able to receive payments. Further, subsequent to the approval of a golden parachute agreement, there is a serious concern with potential further deterioration of a regulated entity or OF and the effect that a golden parachute payment could have on its safety and soundness. To address that concern, FHFA believes that a review of the golden parachute payment, and the circumstances of the Bank during the period in which the payment is actually being made, is necessary. For that reason, proposed § 1231.6 contains procedures for a regulated entity or OF to apply for the consent of the Director to make a golden parachute payment by submission of a letter application. Among factors that must be addressed in the filing seeking approval of the payment are the cost of the payment and the effect that the payment will have on the capital and earnings of the regulated entity (proposed § 1231.6(c)(4)). In addition, the

regulation would require FHFA, among other factors, to determine the degree to which the proposed payment represents a reasonable payment for services rendered over the period of employment (proposed § 1231.3(b)(2)(ii)). FHFA recognizes that this factor could be viewed very differently at the time an individual finishes employment than at the time the individual began employment.

Having noted above specific instances that would require the Director's approval, FHFA emphasizes that under § 1231.3 of the Proposal, a regulated entity or OF may agree to make or may make a golden parachute payment that the Director determines is permissible. A regulated entity or OF always may apply for a determination under this exception if a golden parachute payment is not otherwise permissible.

In making the determination to permit a golden parachute agreement or payment, the Director may consider the factors set forth in proposed § 1231.3(b)(2)(i) through (iii), which include consideration of the case-specific facts and circumstances surrounding the golden parachute payment. For example, the Director may consider mitigating factors in determining whether to permit a golden parachute payment. Such mitigating factors may include, among others, the individual's history of beneficial contribution to the regulated entity, and cooperation with FHFA's relevant remediation efforts.

Importantly, the presence of any of the negative factors enumerated in proposed § 1231.3(b)(2) is not an absolute bar to the approval of a golden parachute payment. Absent mitigating factors, there would be a presumption if any of those factors were present that the golden parachute application should be denied, however, that presumption can be overcome and the Director has discretion to do so.

#### B. Specific Comments

Eleven Banks and OF noted that in paragraph (1) of the term “golden parachute payment” in proposed § 1231.2, that term is defined to mean “[a]ny payment (or any agreement to make any payment) in the nature of compensation by any regulated entity or the Office of Finance for the benefit of any current or former entity-affiliated party pursuant to an obligation of such regulated entity or the Office of Finance. . . .”

[Emphasis added.] They requested the express inclusion of a specific definition of compensation in the final rule to ensure that the term “golden parachute payment” will only apply in the circumstances in connection with employment. Specifically, they sought assurance that the final rule would not apply under any circumstances to non-employment payments, such as debt service payments from a Bank to OF, payments of advance proceeds, dividends, deposit account withdrawals, and Affordable Housing Program (AHP) funds from a Bank to a member institution. They also requested exclusion of payments to other parties (including payments to Bank directors) on the basis that payments to such parties are not connected with an employee relationship with a Bank.

The Safety and Soundness Act provision on golden parachute payments, the Federal Deposit Insurance Act provision on which it is based, and the FDIC rule on which FHFA’s Proposal is based, all define a golden parachute payment as being “in the nature of compensation,” but none defines the term “compensation.” The FDIC included the qualifying phrase “in the nature of compensation” in its final regulation to make clear that the FDIC did not intend to restrict institutions, even those that are troubled, from paying terminating employees accrued but unused benefits, such as vacation. FDIC also noted that the qualifying phrase is used to show that a certain payment should be treated

as a golden parachute because the regulators have historically treated it as compensation, e.g., payments under “split dollar” insurance agreements.<sup>9</sup>

Against the statutory background, and the treatment of the concept by the FDIC in its regulation, FHFA understands “compensation” to be payment for employment or services rendered by individuals. So understood, the concept does not include the various types of payments from a Bank to members that the commenters expressed concern about: payments of advance proceeds, dividends, deposit account withdrawals, and AHP funds; nor does it include debt service payments from Banks to OF.

Members of the regulated entities’ boards of directors fall within the definition of “entity-affiliated party” as stated in the statute and the rule. They are responsible for the governance and oversight of management of the regulated entity, and FHFA believes that there is no reason to exclude them from the rule.

Eleven Banks and OF commented on the exception to the term “golden parachute payment” for nondiscriminatory severance plans. That exception requires that the severance plan provide payments for all eligible employees upon involuntary termination, that it provide no more than 12 months’ severance, and that it have been approved by the Director if it was adopted by the regulated entity when it was subject to a triggering event. The commenters requested that FHFA modify this exception in the final rule to provide that a Bank’s agreement to pay severance to a rank-and-file employee (an employee who is not an “executive officer” under FHFA regulations) in an amount not exceeding compensation paid to the employee during the 12 (or, as seven Banks requested, six) months preceding a negotiated termination of his or her employment be excluded from the definition of “golden parachute payment,” and thus not require FHFA

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<sup>9</sup> 60 FR 16069 – 16082 (March 29, 1995).

approval even if a triggering event were in effect with regard to the Bank. They stated that such an exclusion would ensure that the Bank retain the flexibility to conduct its ordinary-course personnel operations without the need for FHFA approval of customary limited payments in connection with negotiated terminations.

The exception for nondiscriminatory severance plans, as drafted in the Proposal, derives from two aspects of the statute. First, Congress chose a definition of “entity-affiliated party” that has broader coverage than the term “executive officer” as defined in section 4502(12) of the Safety and Soundness Act (12 U.S.C. 4502(12)) with respect to the Director’s authority to prohibit and withhold executive compensation under section 1318(a) of the Safety and Soundness Act (12 U.S.C. 4518(a)). The definition that Congress enacted includes rank-and-file employees. Second, the statute excepts “nondiscriminatory benefit plans,” an exception that FHFA has determined includes nondiscriminatory severance plans. Because the plan must be nondiscriminatory, individually negotiated severance arrangements do not fall within the exception. Like most of the rest of the Proposal, this provision is based on the FDIC’s rule, which contains the same exception for nondiscriminatory severance plans. Banks and thrifts have been operating under that rule for the past 15 years.

After further review of the exception for nondiscriminatory severance pay plans, FHFA has determined to make a different modification to that exception, revising it to limit its effect to executives whose salary does not exceed \$300,000. FHFA believes that compensation of such top executives may be so high that the payment of a full year’s severance may be inappropriate, when their institution is in a troubled condition. However, FHFA notes that whether the recipient of severance pay is a rank-and-file

employee or a top executive, the Director continues to have discretion to approve payment under the regulator’s approval exception discussed earlier (proposed § 1231.3(b)(1)(i)).

Nine Banks and OF noted that, under paragraph (3)(i) of the definition of “bona fide deferred compensation plan or arrangement” in proposed § 1231.2, a plan or arrangement that would otherwise qualify for an exclusion from treatment as a golden parachute payment would not qualify for such treatment if the plan or arrangement were not in effect at least one year prior to the occurrence of a triggering event. Furthermore, they noted that under paragraph (3)(ii) of the “bona fide deferred compensation plan or arrangement” definition, an increase in benefits payable under a qualifying plan or arrangement pursuant to an amendment made during the one-year period prior to the occurrence of a triggering event would appear not to be excluded from the definition of a “golden parachute payment.”

The commenters requested that paragraphs (3)(i) and (ii) of the definition of “bona fide deferred compensation plan or arrangement” in proposed § 1231.2 either be modified to provide that these one-year rules are subject to waiver by the Director on a case-by-case basis, or that FHFA clarify that a Bank could apply for approval to make a payment with respect to the plan or increased benefits under proposed §§ 1231.3(b)(1)(i) and 1231.6. In response, as noted earlier, FHFA is providing a blanket grandfathered status to all deferred compensation plans in place as of the Re-proposal’s publication date. Moreover, FHFA confirms that a regulated entity or OF always may apply for a waiver by the Director on a case-specific basis for bona fide deferred compensation plans or arrangements that are not grandfathered.



Additionally, the commenters requested that FHFA except amendments to nonqualified deferred compensation plans and supplemental retirement plans that are made to comply with law. In response, FHFA has added the following language to the end of paragraph (3)(ii) of the definition of the term “bona fide deferred compensation plan or arrangement”: “provided that changes required by law should be disregarded in determining whether a plan provision has been in effect for one year.”

Ten Banks and OF commented that the definition of “bona fide deferred compensation plan or arrangement” in proposed § 1231.2 permits payments from plans that segregate or otherwise set aside assets in a trust that may only be used to pay plan and other benefits. They requested that FHFA amend paragraphs (1)(ii) and (3)(vi) of the definition in the final rule to include “and related expenses” after “benefits” in order to account for the fact that rabbi trusts often pay certain expenses. FHFA agrees with the comment and has revised the paragraphs as requested.

Nine Banks, OF, and the Chairs of the Banks requested that FHFA modify the circumstances that constitute one of the triggering events set forth in the definition of the term “golden parachute payment” (paragraphs (1)(ii)(A) through (D) of the term “golden parachute payment” in proposed § 1231.2). The event that was the subject of concern is contained in paragraph (1)(ii)(D): when a Bank or OF is assigned a composite rating of 3 or 4 by FHFA.

The commenters noted that the Federal Housing Finance Board Office of Supervision Examination Manual (Manual) draws a sharp distinction between a composite 3- and a composite 4-rating. The Manual provides that the general policy in regard to a composite 3-rated Bank is that supervisory action will be taken to address

identified deficiencies or weaknesses. In contrast, the Manual provides that the general policy in regard to a composite 4-rated Bank is that a formal enforcement action will be taken to address identified deficiencies or weaknesses. They stated that the restrictions of the golden parachute rule should not be triggered in circumstances that are not viewed as being serious enough to require formal enforcement action. For this reason, they requested that the portion of proposed paragraph (l)(ii)(D) of the definition of “golden parachute payment” in proposed § 1231.2, which reads “or the Federal Home Loan Bank or the Office of Finance is assigned a composite rating of 3 or 4 by FHFA” should be revised to delete “3 or.”

In the meantime, FHFA has adopted an examination rating system that results in a composite rating from 1 to 5, analogous to that used by the Federal banking agencies.<sup>10</sup> FHFA has revised the definition of “golden parachute payment” to refer to regulated entities with a composite rating of 4 or 5, as does the FDIC’s golden parachute regulation.<sup>11</sup> However, the Director retains the discretion to determine, on a case-by-case basis, whether a 3-rated Bank (or an Enterprise rated “Significant Concerns”) is in a “troubled condition.” Should the Director make such a determination, the golden parachute restrictions would apply.

Eight Banks and OF requested that FHFA modify the definition of the term “nondiscriminatory” in the final rule. The term relates to the exception from the golden parachute restrictions for a nondiscriminatory severance plan or arrangement (paragraph (2)(v) of the term “golden parachute payment” in proposed § 1231.2). As proposed, “nondiscriminatory” is defined to mean:

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<sup>10</sup> 77 FR 67644 (Nov. 13, 2012).

<sup>11</sup> 12 CFR 303.101(c)(1).

. . . that the plan, contract, or arrangement in question applies to all employees of a regulated entity or the Office of Finance who meet reasonable and customary eligibility requirements applicable to all employees, such as minimum length of service requirements. A nondiscriminatory plan, contract, or arrangement may provide different benefits based only on objective criteria such as salary, total compensation, length of service, job grade, or classification, which are applied on a proportionate basis (with a variance in severance benefits relating to any criterion of plus or minus ten percent) to groups of employees consisting of not less than the lesser of 33 percent of employees or 1,000 employees. [Emphasis added.]

The commenters acknowledged that this provision is similar to the corresponding provision in the FDIC regulation on golden parachute payments, and that in comment letters responding to prior FHFA rulemaking, many of the Banks urged FHFA to add provisions similar to those in the FDIC regulation. In this case, however, they believe that the objective criteria and application requirements (in italics above) should be modified based on the difference in employee size between the Banks and the depository institutions and holding companies to which the FDIC's regulation applies. They stated that, while many of the entities regulated by the FDIC have tens of thousands of employees, the Banks each generally employ fewer than 400 individuals, and most employ fewer than 300.

In recognition of the difference in employee size between the Banks and the entities regulated by the FDIC, the commenters requested that FHFA delete the provision prohibiting a variance in benefits of more than plus or minus ten percent in the final regulation. They also requested that FHFA reduce the 33 percent threshold to 20 percent, and reduce the "1000 employees" to 50 employees or to such other smaller percentage and number that FHFA determines is appropriate in light of the relatively small size of the Banks' and OF's staffs.

In response to this request for modification, FHFA notes that entities regulated by the FDIC under its golden parachute payments regulation are not confined to large holding companies and banks with a correspondingly large number of employees. FDIC-regulated entities also include mid- and small-size banks and thrifts that have correspondingly small numbers of employees. The FDIC has implemented the criteria contained in the term “nondiscriminatory” under its regulation effective for all the covered entities since 1996, regardless of the differences in size and employee base. FHFA believes that the Banks’ size and number of employees is not dissimilar to many of the entities regulated by the FDIC. For this reason, FHFA has determined not to modify the definition of “nondiscriminatory” in the final rule.

The OF requested that the final rule be modified so that it does not apply to OF or any parties associated with it. The OF asserted that Congress intended that the golden parachute provisions in section 1318(e) (12 U.S.C. 4518(e)) of the Safety and Soundness Act, as amended by section 1114 of HERA, apply only to golden parachute payments made by a “regulated entity.” The OF asserted that the clear intent of Congress was to exclude OF from the reach of the provisions.

In response to OF’s request, FHFA notes, as it did when proposing this rule,<sup>12</sup> the following reasons why it is important and appropriate for FHFA to apply the golden parachute provisions to OF. As relevant background, OF is a joint office of the Banks that was established by the Federal Housing Finance Board (FHFB), a predecessor to FHFA. The OF is governed by a seventeen-person board of directors, consisting of all 12 Bank presidents and five independent members. Under the regulations of FHFB, OF is subject to the same regulatory oversight authority and enforcement powers as are the

Banks and their respective directors, officers, and employees.<sup>13</sup> The OF also is subject to the cease-and-desist authority of FHFA, and its directors, officers and management are subject to the removal and prohibition authority of FHFA.<sup>14</sup>

Moreover, as FHFA stated in the Proposal, although OF is not directly covered by section 1318(e), it is subject to the Director's "general regulatory authority" under section 1311(b)(2) of the Safety and Soundness Act (12 U.S.C. 4511(b)(2)), as amended by HERA. The Director is required to exercise that authority as necessary to ensure that the purposes of the Safety and Soundness Act, the authorizing statutes, and other applicable laws are carried out. Because of the unique nature of OF and the interrelationship between it and the Banks, FHFA believes that the purposes underlying the limitations on golden parachute payments can best be carried out if the limitations are consistent between the Banks and OF, their joint office. Therefore, based on its general regulatory authority over OF, FHFA believes that the Director's oversight over golden parachutes should continue to apply to OF in the Re-proposal.

Subsequent to FHFA's issuance of the Proposal, the Stop Trading on Congressional Knowledge Act of 2012, S. 2038 (the "STOCK Act") was enacted. See Public Law No. 112-105, section 16 (April 4, 2012) (codified at 12 U.S.C. 4518a). Section 16 of the STOCK Act prohibits senior executives of any Enterprise in conservatorship from receiving bonuses during any period of conservatorship on or after the date of enactment. Section 16 would require FHFA to deny any golden parachute payment that FHFA determines is a bonus to any senior executive of any Enterprise during any period that the Enterprise is in conservatorship. FHFA will implement any

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<sup>12</sup> 74 FR 30976 (June 29, 2009).

<sup>13</sup> 12 CFR 1273.4 and 1273.7.

final rule on golden parachute payments in a manner consistent with the STOCK Act.

## **V. Differences Between Banks and Enterprises**

Section 1313(f) of the Safety and Soundness Act (12 U.S.C. 4513(f)), as amended by section 1201 of HERA, requires the Director, when promulgating regulations relating to the Banks, to consider the differences between the Banks and the Enterprises with respect to the Banks' cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability. The Director may also consider any other differences that are deemed appropriate. In preparing the Re-proposal, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors. The Director requests comments from the public about whether differences related to these factors should result in a revision of the Re-proposal as it relates to the Banks.

### **Regulatory Impact**

#### Paperwork Reduction Act

This proposed rule does not contain any information collection requirement that requires the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3501 et seq.).

#### Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant

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<sup>14</sup> 12 U.S.C. 4631(a) and 4636a(a).

economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of this proposed rule under the Regulatory Flexibility Act. FHFA certifies that this proposed rule is not likely to have a significant economic impact on a substantial number of small business entities because this proposed rule is applicable only to the regulated entities which are not small entities for the purposes of the Regulatory Flexibility Act.

#### **List of Subjects in 12 CFR Part 1231**

Golden parachutes, Government-sponsored enterprises, Indemnification.

Accordingly, for reasons stated in the Supplementary Information, under the authority of 12 U.S.C. 4518(e) and 4526, FHFA proposes to amend part 1231 of subchapter B of title 12 CFR Chapter XII as follows:

#### **PART 1231 — GOLDEN PARACHUTE AND INDEMNIFICATION PAYMENTS**

1. The authority citation for part 1231 is revised to read as follows:

**Authority:** 12 U.S.C. 4518(e), 4518a, 4526.

2. The heading to part 1231 is revised to read as set forth above.

3. Section 1231.1 is revised to read as follows:

##### **§ 1231.1 Purpose.**

The purpose of this part is to implement section 1318(e) of the Safety and Soundness Act (12 U.S.C. 4518(e)) by setting forth the standards that the Director will take into consideration in determining whether to limit or prohibit golden parachute payments and by setting forth prohibited and permissible indemnification payments that regulated entities and the Office of Finance may make to entity-affiliated parties.

4. Section 1231.2 is amended by:

- a. Removing the paragraph designations and arranging definitions in alphabetical order;
- b. Removing the reserved paragraphs (l) through (n);
- c. Adding in alphabetical order definitions for the terms “Benefit plan”, “Bona fide deferred compensation plan or arrangement”, “Nondiscriminatory”, “Payment”, and “Safety and Soundness Act”; and
- d. Revising the definition for the terms “Entity-affiliated party”, “Golden parachute payment”, and “Troubled condition”.

The additions and revisions read as follows:

**§ 1231.2 Definitions.**

\* \* \* \* \*

Benefit plan means any plan, contract, agreement, or other arrangement which is an “employee welfare benefit plan” as that term is defined in section 3(1) of the Employee Retirement Income Security Act of 1974, as amended (29 U.S.C. 1002(1)), or other usual and customary plans such as dependent care, tuition reimbursement, group legal services or cafeteria plans; provided however, that such term shall not include any plan intended to be subject to paragraphs (2)(iii) and (v) of the term golden parachute payment as defined in this section.

Bona fide deferred compensation plan or arrangement means any plan, contract, agreement or other arrangement whereby:

(1) An entity-affiliated party voluntarily elects to defer all or a portion of the reasonable compensation, wages or fees paid for services rendered which otherwise would have been paid to such party at the time the services were rendered (including a



plan that provides for the crediting of a reasonable investment return on such elective deferrals) and the regulated entity or the Office of Finance either:

(i) Recognizes compensation expense and accrues a liability for the benefit payments according to generally accepted accounting principles (GAAP); or

(ii) Segregates or otherwise sets aside assets in a trust which may only be used to pay plan and other benefits and related expenses, except that the assets of such trust may be available to satisfy claims of creditors of the regulated entities or the Office of Finance in the case of insolvency; or

(2) A regulated entity or the Office of Finance establishes a nonqualified deferred compensation or supplemental retirement plan, other than an elective deferral plan described in paragraph (1) of this definition:

(i) Primarily for the purpose of providing benefits for certain entity-affiliated parties in excess of the limitations on contributions and benefits imposed by sections 401(a)(17), 402(g), 415, or any other applicable provision of the Internal Revenue Code of 1986 (26 U.S.C. 401(a)(17), 402(g), 415); or

(ii) Primarily for the purpose of providing supplemental retirement benefits or other deferred compensation for a select group of directors, management or highly compensated employees (excluding severance payments described in paragraph (2)(v) of the term golden parachute payment as defined in this section and permissible golden parachute payments described in § 1231.3(b)); and

(3) In the case of any nonqualified deferred compensation or supplemental retirement plans as described in paragraphs (1) and (2) of this definition, the following requirements shall apply:

(i) The plan was in effect at least one year prior to any of the events described in paragraph (1)(ii) of the term golden parachute payment as defined in this section;

(ii) Any payment made pursuant to such plan is made in accordance with the terms of the plan as in effect no later than one year prior to any of the events described in paragraph (1)(ii) of the term golden parachute payment as defined in this section and in accordance with any amendments to such plan during such one-year period that do not increase the benefits payable thereunder, provided that changes required by law should be disregarded in determining whether a plan provision has been in effect for one year;

(iii) The entity-affiliated party has a vested right, as defined under the applicable plan document, at the time of termination of employment to payments under such plan;

(iv) Benefits under such plan are accrued each period only for current or prior service rendered to the employer (except that an allowance may be made for service with a predecessor employer);

(v) Any payment made pursuant to such plan is not based on any discretionary acceleration of vesting or accrual of benefits which occurs at any time later than one year prior to any of the events described in paragraph (1)(ii) of the term golden parachute payment as defined in this section;

(vi) The regulated entity or the Office of Finance has previously recognized compensation expense and accrued a liability for the benefit payments according to GAAP or segregated or otherwise set aside assets in a trust which may only be used to pay plan benefits and related expenses, except that the assets of such trust may be available to satisfy claims of the regulated entity's creditors in the case of insolvency; and

(vii) Payments pursuant to such plans shall not be in excess of the accrued

liability computed in accordance with GAAP.

\* \* \* \* \*

Entity-affiliated party means:

(1) With respect to the Office of Finance, any director, officer, or management of the Office of Finance; and

(2) With respect to a regulated entity:

(i) Any director, officer, employee, or controlling stockholder of, or agent for, a regulated entity;

(ii) Any shareholder, affiliate, consultant, or joint venture partner of a regulated entity, and any other person, as determined by the Director (by regulation or on a case-by-case basis) that participates in the conduct of the affairs of a regulated entity, provided that a member of a Federal Home Loan Bank shall not be deemed to have participated in the affairs of that Federal Home Loan Bank solely by virtue of being a shareholder of, and obtaining advances from, that Federal Home Loan Bank;

(iii) Any independent contractor for a regulated entity (including any attorney, appraiser, or accountant) if:

(A) The independent contractor knowingly or recklessly participates in any violation of any law or regulation, any breach of fiduciary duty, or any unsafe or unsound practice; and

(B) Such violation, breach, or practice caused, or is likely to cause, more than a minimal financial loss to, or a significant adverse effect on, the regulated entity;

(iv) Any not-for-profit corporation that receives its principal funding, on an ongoing basis, from any regulated entity.

\* \* \* \* \*

Golden parachute payment means:

(1) Any payment (or any agreement to make any payment) in the nature of compensation by any regulated entity or the Office of Finance for the benefit of any current or former entity-affiliated party pursuant to an obligation of such regulated entity or the Office of Finance that:

(i) Is contingent on, or by its terms is payable on or after, the termination of such party's primary employment or affiliation with the regulated entity or the Office of Finance; and

(ii) Is received on or after, or is made in contemplation of, any of the following events:

(A) The insolvency (or similar event) of the regulated entity which is making the payment;

(B) The appointment of any conservator or receiver for such regulated entity;

(C) The regulated entity is in a troubled condition; or

(D) The regulated entity is assigned a composite rating of 4 or 5 by FHFA.

(2) Exceptions. The term golden parachute payment shall not include:

(i) Any payment made pursuant to a pension or retirement plan that is qualified (or is intended within a reasonable period of time to be qualified) under section 401 of the Internal Revenue Code of 1986 (26 U.S.C. 401) or pursuant to a pension or other retirement plan that is governed by the laws of any foreign country;

(ii) Any payment made pursuant to a "benefit plan" as that term is defined in this section;

(iii) Any payment made pursuant to a “bona fide deferred compensation plan or arrangement” as that term is defined in this section;

(iv) Any payment made by reason of death or by reason of termination caused by the disability of an entity-affiliated party; or

(v) Any payment made pursuant to a nondiscriminatory severance pay plan or arrangement that provides for payment of severance benefits to all eligible employees upon involuntary termination other than for cause, voluntary resignation, or early retirement; provided that:

(A) No employee shall receive any such payment that exceeds the base compensation paid to such employee during the 12 months (or such longer period or greater benefit as the Director shall consent to) immediately preceding termination of employment, resignation, or early retirement, and such severance pay plan or arrangement shall not have been adopted or modified to increase the amount or scope of severance benefits at a time when the regulated entity or the Office of Finance is in a condition specified in paragraph (1)(ii) of the term golden parachute payment as defined in this section or in contemplation of such a condition without the prior written consent of the Director; and

(B) If an employee’s salary exceeds \$300,000, the exception provided under this paragraph (2)(v) shall not apply to that employee; or

(vi) Any severance or similar payment that is required to be made pursuant to a state statute or foreign law that is applicable to all employers within the appropriate jurisdiction (with the exception of employers that may be exempt due to their small number of employees or other similar criteria.

\* \* \* \* \*

Nondiscriminatory means that the plan, contract, or arrangement in question applies to all employees of a regulated entity or the Office of Finance who meet reasonable and customary eligibility requirements applicable to all employees, such as minimum length of service requirements. A nondiscriminatory plan, contract, or arrangement may provide different benefits based only on objective criteria such as salary, total compensation, length of service, job grade, or classification, which are applied on a proportionate basis (with a variance in severance benefits relating to any criterion of plus or minus ten percent) to groups of employees consisting of not less than the lesser of 33 percent of employees or 1,000 employees.

\* \* \* \* \*

Payment means:

- (1) Any direct or indirect transfer of any funds or any asset;
- (2) Any forgiveness of any debt or other obligation;
- (3) The conferring of any benefit, including but not limited to stock options and stock appreciation rights; and
- (4) Any segregation of any funds or assets, the establishment or funding of any trust or the purchase of or arrangement for any letter of credit or other instrument, for the purpose of making, or pursuant to any agreement to make, any payment on or after the date on which such funds or assets are segregated, or at the time of or after such trust is established or letter of credit or other instrument is made available, without regard to whether the obligation to make such payment is contingent on:
  - (i) The determination, after such date, of the liability for the payment of such

amount; or

(ii) The liquidation, after such date, of the amount of such payment.

\* \* \* \* \*

Safety and Soundness Act means the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 et seq.), as amended.

Troubled condition means a regulated entity that:

(1) Is subject to a cease-and-desist order or written agreement issued by FHFA that requires action to improve the financial condition of the regulated entity or is subject to a proceeding initiated by the Director, which contemplates the issuance of an order that requires action to improve the financial condition of the regulated entity, unless otherwise informed in writing by FHFA; or

(2) Is informed in writing by the Director that it is in a troubled condition for purposes of the requirements of this part on the basis of the most recent report of examination or other information available to FHFA, on account of its financial condition, risk profile, or management deficiencies.

5. Section 1231.3 is added to read as follows:

**§ 1231.3 Golden parachute payments.**

(a) Prohibited golden parachute payments. No regulated entity or the Office of Finance shall make or agree to make any golden parachute payment, except as provided in this part.

(b) Permissible golden parachute payments. (1) A regulated entity or the Office of Finance may agree to make or may make a golden parachute payment if and to the extent that:

(i) The Director determines that such a payment or agreement is permissible; or

(ii) Such an agreement is made in order to hire a person to become an entity-affiliated party either at a time when the regulated entity or the Office of Finance satisfies, or in an effort to prevent it from imminently satisfying, any of the criteria set forth in paragraph (1)(ii) of the term golden parachute payment as defined in § 1231.2 of this part, and the Director consents in writing to the amount and terms of the golden parachute payment. Such consent by the Director shall not improve the entity-affiliated party's position in the event of the insolvency of the regulated entity since such consent can neither bind a receiver nor affect the provability of receivership claims; or

(iii) Such a payment is made pursuant to an agreement which provides for a reasonable severance payment, not to exceed 12 months salary, to an entity-affiliated party in the event of a change in control of the regulated entity; provided, however, that a regulated entity shall obtain the consent of the Director prior to making such a payment, and this paragraph (b)(1)(iii) shall not apply to any change in control of a regulated entity that results from the regulated entity being placed into conservatorship or receivership; and

(iv) A regulated entity or the Office of Finance making a request pursuant to paragraphs (b)(1)(i) through (iii) of this section shall demonstrate that it does not possess and is not aware of any information, evidence, documents, or other materials that would indicate that there is a reasonable basis to believe, at the time such payment is proposed to be made, that:

(A) The entity-affiliated party has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the regulated entity or the



Office of Finance that is likely to have a material adverse effect on the regulated entity or the Office of Finance;

(B) The entity-affiliated party is substantially responsible for the insolvency of, the appointment of a conservator or receiver for, or the troubled condition of the regulated entity;

(C) The entity-affiliated party has materially violated any applicable Federal or State law or regulation that has had or is likely to have a material effect on the regulated entity or the Office of Finance; and

(D) The entity-affiliated party has violated or conspired to violate sections 215, 657, 1006, 1014, or 1344 of title 18 of the United States Code, or section 1341 or 1343 of such title affecting a “financial institution” as the term is defined in title 18 of the United States Code (18 U.S.C. 20).

(2) In making a determination under paragraphs (b)(1)(i) through (iii) of this section, the Director may consider:

(i) Whether, and to what degree, the entity-affiliated party was in a position of managerial or fiduciary responsibility;

(ii) The length of time the entity-affiliated party was affiliated with the regulated entity or the Office of Finance, and the degree to which the proposed payment represents a reasonable payment for services rendered over the period of employment; and

(iii) Any other factor the Director determines relevant to the facts and circumstances surrounding the golden parachute payment, including any fraudulent act or omission, breach of fiduciary duty, violation of law, rule, regulation, order, or written agreement, and the level of willful misconduct, breach of fiduciary duty, and malfeasance

on the part of the entity-affiliated party.

6. Section 1231.5 is revised to read as follows:

**§ 1231.5 Applicability in the event of receivership.**

The provisions of this part, or any consent or approval granted under the provisions of this part by FHFA, shall not in any way bind any receiver of a regulated entity in receivership. Any consent or approval granted under the provisions of this part by FHFA shall not in any way obligate FHFA or receiver to pay any claim or obligation pursuant to any golden parachute, severance, indemnification, or other agreement. Nothing in this part may be construed to permit the payment of salary or any liability or legal expense of an entity-affiliated party contrary to section 1318(e)(3) of the Safety and Soundness Act (12 U.S.C. 4518(e)(3)).

7. Section 1231.6 is added to read as follows:

**§ 1231.6 Filing instructions.**

(a) Scope. This section contains the procedures to apply for the consent of the Director to make golden parachute payments under § 1231.3(b) of this part (including entering into agreements to make such payments) or to make excess nondiscriminatory severance plan payments under paragraph (2)(v) of the term golden parachute payment as defined in § 1231.2 of this part.

(b) Where to file. A regulated entity or the Office of Finance must submit a letter application to the Manager, Executive Compensation, Division of Supervision Policy and Support.

(c) Content of filing. The letter application must contain the following:

(1) The reasons why the regulated entity or the Office of Finance seeks to make the payment;

(2) An identification of the entity-affiliated party who will receive the payment;

(3) A copy of any contract or agreement regarding the subject matter of the filing;

(4) The cost of the proposed payment and its impact on the capital and earnings of the regulated entity;

(5) The reasons why the consent to the payment should be granted; and

(6) Certification and documentation as to each of the factors listed in § 1231.3(b)(1)(iv).

(d) Additional information. FHFA may request additional information at any time during the processing of the letter application.

(e) Written notice. FHFA shall provide the applicant with written notice of the decision as soon as it is rendered.

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Edward J. DeMarco,  
Acting Director, Federal Housing Finance Agency.

\_\_ May 6, 2013

Date

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